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Intuitive Surgical, Inc. (ISRG) CEO Gary Guthart Presents at Morgan Stanley 18th Annual Global Healthcare Conference Transcript

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Intuitive Surgical, Inc. (NASDAQ:ISRG) Morgan Stanley 18th Annual Global Healthcare Conference September 15, 2020 12:30 PM ET

Company Participants

David Lewis - Morgan Stanley

Conference Call Participants

Marshall Mohr - CFO

Philip Kim - Head of IR

David Lewis

Well, good morning, good afternoon, everyone depending on your location assuming this morning. Welcome to the Morgan Stanley Healthcare Conference 2020 as we progress through day two of yesterday's exciting meetings. It's my pleasure to have with us here as we progress through day two Intuitive Surgical, both their CFO, Marshall Mohr and Philip Kim, VP of IR.

Philip is going to give us a brief disclosure before I [indiscernible] do that. Just remember my research disclosures are at the morganstanley.com/researchdisclosures website. You see fun facts about me and Philip, you're going to give us some brief forward-looking statements and then we'll jump straight into Q&A.

Philip Kim

Before we started, I'd like to inform you that comments mentioned this afternoon may be deemed to contain forward-looking statements. Actual results may differ materially from those expressed or implied as a result of certain risks and uncertainties, which are described in detail in our SEC filings. Investors are cautioned not to place undue reliance on such forward-looking statements.

David Lewis

Thanks Dolph [ph]. That was short and sweet. I appreciate it. So Marshall, let's start with you when we started with a lot of companies here during the last couple of days. Just talking about recovery, you gave us an update on certain procedures from close to 90% now at the end of second quarter.

How have you seen sort of procedure recovery in certain events, why August September timeframe? Have things continued to recover. I think you were asked about July and you set the trend lines were murky in July. I imagine you've cleaned up a little bit here in the last two months or so. So how has recovery progressed here in the last several months?

Philip Kim

Yeah just to rewind the clock, we saw recovery in Q2 and as you said David, things have recovered nicely through about the middle to June and we started to see a little bit of a drop off and I think that drop off was reflective of the extension of COVID virus spread in the United States, particularly in states like Arizona, Texas and Florida and in fact I think it was early July in Texas basically said that the favorable procedure should be deferred and that they would dedicate their resources to COVID.

So we said in our call that we had anticipated that that would cause a slower recovery or even a resurgence in terms of lower procedures. We're not going to comment on inter-company or inter-quarter procedures. Just tell you that you should follow all what you're hearing in the press and that translates into how procedures are recovering overall.

One other factor I think that you should take into consideration is as opposed to COVID virus and the resources that the hospitals dedicate of the virus that cause lower numbers of elective procedures or deferrable procedures to be done, the other element here is patients. Patients are reluctant to be diagnosed and also to be treated and so we think that as we talk to our hospital customers and our surgeons, we're hearing that patients are reluctant to come back to the hospital.

The things that we treat though are we're treating very sick patients and so eventually they need to be treated. We don't think there's some exodus to some other type of treatment. We think that ultimately they'll be treated with eventually, but the combination of COVID virus patient views really can make it very unpredictable as to when those patients return.

David Lewis

Okay. Understood. So can you parse out some of your comments there actually maybe confusing for some investors, general surgery probably recovers faster than most investors would have thought at the time, just based on procedure acuity and you've kind of commented where you were at the end of June. OI [ph] commented on researchers dynamics in July. You're bringing out some resource allocation issues with some others as well.

But I think I am hearing is there is no reason to believe you recovered X% through June. There is no reason to believe your recovery deviated materially from what other medical device companies are sort of seeing, which has been generally a consistent trend to recovery. You're bringing us some different things, but I just -- you recovered right in line appears faster. I am trying to figure out what's broken trend here in the third quarter. It doesn't sound like there is.

Philip Kim

Yeah I don't think there is anything unique about the di vinci surgery, my comment we're treating very sick patients and so it's a different thing let's say orthopedics or something where it is more deferrable, but as far as this type of surgeries we did, there is no difference between surgery.

David Lewis

Okay. And you and I talked at the quarter about this reschedule patients versus new patients and pretty unique company right because you got pretty tracking information and good sense of maybe de novo patients versus reschedule patients. Any concern do you have about sort of backlog? You talked about new patient willingness, but I think you sort of felt at the time of the second quarter that you weren't I think you said you think you had worked down most of that backlog and you don't think there was a significant backlog quote unquote "effect".

How are you feeling about new patients without rescheduling patient dynamic here into the third quarter?

Philip Kim

Yeah, and actually what happened in Q2 actually we saw less of a backlog, we picked up than we had would have expected. In fact you're right, we have pretty good information and revalidated with surgeons and hospitals and we think that there was substantial backlog at the end of Q2.

And during the period in which there was this recovery, we tried to parse out how much of that was the backlog versus how much of that was just certain you patients. I think less of it was the backlog than we would have anticipated and again, I think that reflects on patient's willingness to come to the hospital to be treated. And so I think when that backlog actually gets done it is questionable.

David Lewis

Okay. Understood. The other dynamic Marshall is the other side of your business, which is systems, I would say in general, the systems business actually fared better than I would have expected in the second quarter better, I think everyone expected and we've heard different things, we've heard the CARES Act, we've heard hospital endowments frankly are in better position than they were back in other prior crises.

How are you feeling about sort of the capital environment and the state of your capital business? Is it is it faring a lot better than you would have expected based on some of these formation factors? We also didn't see Marshall increasing your lease rate in the second quarter where a lot of other robotic companies saw substantial increases in lease rate, you actually sold these systems, and you sold a lot of them. How are you feeling about the capital environment?

Marshall Mohr

Yes, what we said in the Q2 release was capital did exceed our expectations. But in part it was the reflection of in the U.S., we had few IDNs that purchase -- made large purchases for whatever reason, they purchased the product instead of leased it. And those were deals that had been in discussion or negotiation for frankly well over six months.

And so it was the combination of a negotiation over time. What we did see, as we approach the end of the quarter, though was hospitals, sort of deferring purchases as they go off and they try to figure out where they are from a budgetary and finance perspective.

COVID clearly has a severe impact on their finances and their P&L. And so I think that a number of them went off to try to figure that out. I would expect it to be a very stressed capital environment going forward for a few reasons. One was we saw a 27% drop in the utilization of systems. Hospitals will want to fill that capacity before they buy new capital. Second is I think that it will take time for hospitals to recover from the financial impacts of COVID and they recover and when they start to go back to purchasing capital will see that we would expect that they continue to utilize the capital that they have more rather than buying new capital.

The other impact in Q2 that outside of the U.S. was we did 21 systems in China, that was a pleasant upside. And in China, leasing is not possible either. So those systems, the proportion of China's systems relative to the total was higher. And so you get sort of downward pressure on the number of places I take China out, actually get closer to what was the average run rate for leasing for the company.

And if I take out those couple of IDNs, then we're actually higher. So we would anticipate that leasing would increase over time over the next, over the long-term. But clearly in this environment of COVID, we would expect it to increase even more as hospitals struggled to figure out how to purchase things up front.

David Lewis

Okay, so [indiscernible] numbers, Marshall for third quarter actually have systems revenue down a little bit. And I guess that sort of that seems surprising to me. You're saying the environment is still somewhat challenging. But does that make sense to you because my view would be the second quarter really should have been the trough quarter.

That was sort of the freeze quarter, hospitals have been open here in the third quarter, reps have been able to get access to the hospital, delivery of shipments is easier in the third quarter. So I would just sort of assume that capital revenue could be up sequentially versus with the Street has which is down slightly?

Marshall Mohr

Yes, I'm not on that boat, I think we'll see by the way, quarters are always back ended with capital. So could even tell you today with what I think the ultimate result will be for this quarter. But I think the pressure of the 27% utilization decline and hospitals wanting to fill that first. It's going to be really pressured, those are big headwinds. So I'm not confident that we will do better than last quarter or the same as last quarter, which is why we didn't give guidance, we really don't know where it's going to come out given this pressure.

David Lewis

Okay, if anything, Marshall I think about 2021. I know it's really just sort of thinking about that guidance, but either some companies are willing to share, how they think about 2021 relative to 2019. And I wonder anything that you could offer in terms of what's your underlying growth rate was and how 2021 could look relative 2019 either on the top line qualitatively, or just the margin structure perspective, should we assume that 2021 could get back or higher than 2019 margins?

Marshall Mohr

Yes, margin isn't our first objective. Our first objective really is to increase revenue and increase the market opportunity and accelerate the market opportunity. And so we've always said, Hey, if we had the opportunity to expand our market, but it might be at the expense of partial point of a gross margin or a point of gross margin, we would do that. So I wouldn't want anybody to anchor on that, as far as that building leverage, this is the big opportunity.

We are sitting at a point where competition isn't yet here. The timelines for them to get here are a little longer. We have the opportunity to expand then without their competition. We also think that the total opportunity for robotic surgery is huge. So this is the time to really continue to drive investment. You've seen us do a few things in terms of trying to create customer loyalty through the customer relief program, we previously announced, we're rolling out the extended use instruments that will reduce the cost and total cost of surgery.

All of those things are really trying to get to where we increase our penetration into the market. So I think that as I think about 2021, we'll give you whatever we can when we get to January. And I don't know how much that will be because if the virus is still having large impacts or there are large swings in terms of resurgence of that. But I wouldn't bet on increased margins. And as far as I sit here today, I don't know how long this virus is going to have an impact on this. And then there's the after effects of the virus, which is like I said, hospital finances have declined as a result of the costs of the virus and we don't know what that will do with the economic downturn will do overall.

David Lewis

Okay, so you announced in the second quarter that was interesting was this dynamic. The longer use instrumentation, you also helped us quantify what that could be and if you could walk through that a little bit. The first thing that Marshall why now, but you've been working on manufacturing improvement operations for years. Gary's talked about it quite a bit. Why is second quarter in the midst of COVID you choose to roll out this new program that begins in next year basically a month?

Marshall Mohr

Yes, it's in terms of timing with COVID, it's totally coincidental. You're right. We've been working on things on durability and quality of instruments from the day you introduce a product you're constantly working on reducing the cost, improving the supply chain and improving the manufacturability of those products. And there's a lot of little incremental things you do over time, that at the end of the day, we got to a year-ago and we look at it, we really we're seeing far fewer the return rates, the ability to use the instrument and the return rates have declined, the usability of the instruments had increased, we say could we use them for more.

And so we actually go through a validation verification, that really took all those little incremental steps of changing the type of material, changing putting in place automation in the factory that improves quality. It really took all those little things to get to that point where you went back and revalidate them. So to be clear, for everybody that's listening, our instruments generally timed out after 10 uses. There's a set of instruments, not all of them, but a set of instruments that now will be usable for 12 lives to 18 lives depending on the instrument.

And we've announced that and we think that that will be beneficial to customers, obviously, if it's in their cost per use has declined. Simultaneously with that, we're also modifying the price of a few instruments that are used highly in lower acuity surgeries where reimbursements are lower, and specifically [indiscernible] when a hernia, benign hysterectomies and by doing so, then the total cost of those procedures, the combined impact of the extended use as well as the reduction in price for those instruments, then the cost per instrumentation is comparable to other MIS approaches.

So, we think that it was important to announce it as soon as we got it validated, soon as we knew we could give it to a customer who wanted to do that. I would hate to sit in front of a customer later and have to look them in the eye and say yes, I knew it could be used more, I just didn't get it.

So we want to work with our customers, we want to help part of the quadruple includes cost of the surgery itself and lower cost of surgery and so this is all geared toward them.

David Lewis

But are you trying to just, are you trying to grow your business faster or is this a defensive move given competitions coming?

Marshall Mohr

Well, the first one is grow our business faster, our first reaction to things is not to look in the rearview mirror where competition is coming and try to fend that off. It's really how can we penetrate markets as fast as we can. So we believe that there is some level of elasticity in the market. And so by introducing these instruments, we think that we've increased the market and people have asked the question, well how much did you increase it?

We haven't even put the instruments out on the market yet. But what we heard not uncommonly was that a resistance to using da Vinci for let's say Cholecystectomy because of its cost. And in fact, we know that there were hospital administrators that basically told their surgeons you will not do da Vinci surgery or Cholecystectomy. It was just an that came down. We're thinking that this will eliminate that, then it will be up to the surgeons to decide whether or not to use it.

And so we think that it will increase the market share as soon as we figure out what we think that increases will let you know.

David Lewis

Okay, you said a 7% hit to revenue based on these pricing adjustments heading into well, you said it for 2019, you just should use that number loosely for 2021. We assume that we're not going to see the full 7% hit because there has to be some uplift on procedures either in new system sales or specifically in procedures. Is it crazy to assume you get back all of that 7% heading into 2021 where it's the volume totally offsets the pricing cut?

Marshall Mohr

Yes, I mean the timing of that elasticity of when you start to see that increase in procedures is questionable. That's the part, that's hard to predict both because of COVID but just in general, adoption is not an easy thing to predict. So I think it would be aggressive to think that we'll recover all of the lost revenue in one period. But I think that over time you should expect.

David Lewis

Okay. Is this the last issue that we're going to see? I mean it's just one pricing cut, or is this a series of pricing cuts targeting different procedures, different regions, help us put that in context?

Marshall Mohr

Yes, so what we've been describing as the U.S. rollout, OUS, we're looking at similarly, what are the procedures that are lower reimbursement stress. And so the pricing is universal. It's not this is what we did in United States, that's what everybody else gets period. We're actually looking at country by country, what are the procedures, were the reimbursements are stressed that we think we have value. But for the cost of the instrumentation, it's not adapting at the pace that we think it should.

And so we're modifying the pricing of instruments differently in different geographies, the rollouts to those geographies will be Europe later in Q4 and the rest of the world comes at even later than that, mostly because of regulatory requirements around the world particularly in China as an example where the process to reregister instruments is well over a year or so. Chinese standard use instruments for 2020 and so yes, we're trying to take the opportunity.

As far as are we working on other initiatives, we're always working on trying to improve the quality and durability of instrumentation systems. And so at any point in time that we reach sort of this, this point where we think that it can extend the use of instruments and we'll make that step.

But we'll again, it doesn't happen with one program, all of a sudden you're there. It happens with lots of incremental changes over time.

Philip Kim

Yes, David, the quote Darry and Marshall, it’s the virtuous cycle, we gain scale become more efficient, pass along those savings to our customers and then increase penetration in the market. So in the longer-term, our investors should think about virtuous cycle for us.

David Lewis

Okay, so Marshall, I think if I missed this dynamic, you're approaching upper teens if not 20%, type procedure growth in times pre-COVID. By substance, you would not have done this. If you don't think it could expand your market and help you grow faster. So despite those comments about the virtuous cycle, you're going to see some price cuts and some volume adjustments. Is there no reason to believe that the kind of growth that you were seeing sort of pre-COVID that you can get back to that kind of growth, when you think about the existing pipeline and some of these initiatives to expand your TAM?

Marshall Mohr

Yes, I think the opportunity for a computer aided surgery is large, I don't think it changed as a result of COVID. Certainly the timeline at which it adapts has changed because of COVID.

So to your question, do we think we can get back to the same level of growth?

It's a good question. I don't have a specific answer for you other than to say, we believe the market size is the same, now it's even larger with we think with the extended use instruments. And the big question is timing. When do you get there? Is it possible you get back to the same rates of increase, of course, you have the lot of large numbers and adoption curve, that standard way of that but it's not, it's not impossible to get back to those.

David Lewis

Sure. The thing that I've been somewhat surprised on about a year and a half ago maybe longer and Gary came out at a conference and really started talking about Intelligent Surgery, what Intelligent Surgery means to Intuitive and began to device some of the parameters of that, that platform. It's been with the exception of Iris, it's been a little quiet since last year and a half on sort of the formulation of Intelligent Surgery.

But that being said, he came out to speak about for a reason, the company changed from Intuitive Surgical to Intuitive right around the same time. I know you're spending a substantial portion of R&D resources on software and development solutions. So where is Intelligent Surgery? When are investors going to see the commercial fruits of this, what's been a 18 months communication and multi-year investment in Intelligent Surgery?

Marshall Mohr

Yes, so there's a few things. One is the reason for the changes from Intuitive Surgical to Intuitive really had more to do with Ion than it did that we were going to get come out with a whole different business model. Ion is a diagnosis, be used for diagnosis right now versus surgery. So we dropped the surgical. Second thing is, it's not just an Iris. I mean, you look at the stapling instruments and the Intelligence that's been put into stapling instruments, you looked at some of the other technologies that we've rolled out, that really, really that we've tried to incorporate wherever we can. Ion also by the way has a substantial amount of Intelligence in it just as an example, where you're similarly taking a preoperative CT scan, and you're designing a Google roadmap to go get to the suspicious nodules in the lung for biopsy.

So it's, I think we're incorporating those things. But your point is hey look, we talked about something. And that's because we think that there's way more we can do in terms of Intelligent Surgery. And so we're making those investments. You said it's quiet. We did this acquisition of some things in Israel called Orpheus, I think we announced we're making other smaller investments in External Technologies, but we're also growing the group inside the company and so you're right. It's one of the bigger areas of investment for us.

But I think that all I would say is, there are future versions of Iris that will come out, there are things that will do in conjunction with the system itself that will come out and then there will constantly be Intelligence embedded in some of our other instrumentation and so forth.

So, I just tell you stay tuned, you'll see that these things come out over time, but it is a big area for us and for others. You've heard them talk about it too.

David Lewis

If you then select two topics, I want to discuss and one is that the biggest “overhang” and I think during COVID, we've seen this overhang lift a bit as system is to be delayed a little bit and J&J system delayed more materially. But with products still out there. CMR Surgical has a system as well. How are you feeling about the competitive mode you’re now versus a year-ago as you've learned more about these systems and your business model has evolved and I'm specifically wondering this fear that investors have about huge disruption to your business as competitive systems come to market in the next year to two years in some cases?

Marshall Mohr

Yes, I think we feel good about the competitive mode in terms of its increasing as we go through time, we're introducing more and more technologies. I think that increased that mode, we're expanding as fast as we can into the market. I think the more installations, the more training, the more surgeons you have that have adopted that system increases the mode. I think that the extension of timelines for Johnson & Johnson and for Medtronic, they'll also display sort of some changes you see going on with the FDA.

And I don't think that really necessarily changes the mode. Maybe it changes the timelines because it should be applied equally across all and puts us on a more level playing field but it certainly, it put them back in their initial introduction of a product a little bit more than they had anticipated. I think we'll continue to just like I said drive technologies and drive expansion in the market.

David Lewis

As we wrap up, Marshall just a couple of procedure categories. Obviously, general surgery was driving a substantial amount of growth in hernia, why don’t you just give us a sense of where you think you are right now in terms of that total hernia market opportunity, which could be close to a million procedures, where you think you’re on penetration?

And then you talked about cholecystectomy which I never thought would be a massive opportunity. But the reality is, we're seeing currently traction prior to COVID. And even now, some of these extended life initiatives specifically targeted and getting people more up on that train procedure to drive greater adoption. So what are you seeing on sort of adoption and sort of where are we on the hernia adoption curve?

Marshall Mohr

I will let Philip start and then I will chime after.

Philip Kim

Yes, so within hernia, as you said, it's a million procedure category. We're in the early part of that mid-innings with respect to hernia, and then chole that's obviously north of a million procedure category as well. And that's a single-digit penetration type opportunity. And so those are two areas that clearly could benefit from extended use. And so there's clear opportunity there.

Marshall Mohr

Yes, in both of those categories, when we talk about middle innings, we're talking about middle innings of what we thought was the addressable market and the addressable market and each is like in hernia has to do with the surgeon approach, the obesity of the patient and the complexity of the surgery now with extended use instrumentation set as well as reduction in cost. We're hoping that that expands that even beyond what was previously our opportunity. So we're in the middle innings of a subset of the total of each of those markets.

And I hope to have expanded it and hope to see a continued growth. In the case of cholecystectomy, I'm with you, we were there once with a single site. This is different. You call it a training procedure. We're finding it less to be a training procedure and more to be one that is where the surgeons that do multiple different types of procedures are just adopting da Vinci for all. And so where the stick rates, we watch how many times surgeons do the surgery and whether they increase or decrease and we're seeing that stick rates are very good.

David Lewis

Thank you. Chole be bigger than hernia has been for the company?

Marshall Mohr

It could, I think that there's a better case for parts of hernia from the meaning so far the clinical evidence is better for hernia than for cholecystectomy versus other approaches, but in long-term, we'll see because I think that there are some things about cholecystectomy that also.

Philip Kim

Yes, so in chole we see Firefly utilization, high utilization as well. So surgeons can see the procedure in a way they can with the naked eye. So that's some positive feedback we get.

David Lewis

Okay. And just lastly, Marshall, type of capital and quickly as you wrap up here, and what has happened in the broad capital environments, does that also applies to the SP and Ion, I sort of wonder how SP and Ion traction has fared here as we sort of bounce off the bottom of COVID and think about the back half of the year?

Marshall Mohr

Yes, I mean we're excited about both those platforms and that’s how we think about it is that they could be used for multiple different things, right. In the case of Ion I think the experiences to date are really positive. I think that it's achieving the benefits that we had hoped that it would achieve. And what we're working on also was the study, PRECISE study, and if there was a little bit of an interruption in terms of the pace at which cases were done under that study, but we're starting to see some of that pick-up.

And so we're pretty positive about Ion and getting to where, it will the ability to market it more broadly will occur. And then there's Ion in the future and we haven't really pinned our hat on any one particular procedure, but I think it could be used in any tubular structure and a number of different ways. In the case of SP, SP we're thrilled with what's going on in Korea. In Korea, they have approval and they can use it broadly.

They're not limited in terms of what types of procedures and we're seeing broad adoption in multiple different procedures. Those systems will be utilized more extensively than the excise that are installed in Korea, which were already higher than the global average. And so we're watching very carefully to see how it's being used in the United States, we're getting good feedback on transoral procedures and urologic procedures as well. And so I think longer-term, we got a little bit of an interruption again from COVID on trying to push forward with a clinical study for colorectal procedures. Hopefully, we can get back on track and push that forward.

And I think so we haven't predicted when we'll get any kind of an approval for that, obviously, but SP also could be used more broadly than just those three procedures.

David Lewis

Okay, and just lastly, I'll wrap it up here, Marshall was the China quota the remaining 60 systems that were outstanding, do this still kind of progressive at the same time on you expected which is sort of through 2021, are they accelerated or delay. Do you still think that timeline makes sense?

Marshall Mohr

Yes, I think the timeline still makes sense. I think that you're talking about some will get done yet this year and then more of them will get done next year. And as long as they've been allocated, which they have the two years to complete the acquisition and so a lot of it will happen next year.

David Lewis

Okay, with that we're out of time, Marshall. Thanks so much for being here this morning. Enjoy your meetings, we'll talk soon.

End of Q&A

Marshall Mohr

All right, thanks David.

Philip Kim

Thanks.

David Lewis

Thank you.

Question-and-Answer Session

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